

The Testimony of Victor Miramontes

(Former Managing Director and CEO of The North American Development Bank)

Before

**The Subcommittee on International Monetary Policy and Trade
of the**

U.S. House Committee on Financial Services -

**May 2, 2002 Hearing concerning the potential reform of the
North American Development Bank's charter**

Chairman Bereuter, members of the Committee, I thank you for the invitation to appear before you to discuss an issue that is of importance to me not only because of the time and energy I have invested in it professionally, but because of my personal history having grown up on the border in El Paso, Texas. It is an issue of great importance today in terms of the future economic growth and development of the U.S.-Mexico border region. That issue is the North American Development Bank, and the question of what new initiatives and reforms should be undertaken to ensure its continued success. This committee has posed a number of related questions that I will answer to the best of my ability.

Your first question relates to my experience at the Bank. I will address this question as it pertains to my experience with the Bank's policy and structural issues throughout my testimony. But my fundamental answer to this question is simple - I loved every minute of my tenure. I have never worked harder, with more unsolvable issues, or with greater political and financial uncertainty. My

response comes from my being a part of the people and social fabric that make up this unique place in the world. The US-Mexico Border is by definition divided down the middle, yet its patriotic citizens, at times, see a greater divide with the rest of their own nation that doesn't seem to understand the day-to-day issues of the region. It is a region of many opposites and problems that ironically unite it more than divide it. It is a quickly growing family that knows it has a better future as it learns how to effectively exercise its intellectual, political and economic capabilities – in both countries.

I make reference above to the NADBank's "continued success" to clearly suggest to you that the NADBank has had successes thus far. It has had successes despite what I see as significant limitations in the way the institution was initially created. While we can point to the successes of the NADBank, the institution has not lived up to the high expectations with which it was established. The NAFTA political process left border communities with the expectation that the NADBank was created to address all of their community needs with a pool of \$3 Billion in grants or, at least, in paid in capital. Others outside the border region expected the Bank to take over thorny issues and remove them from their own list of problems. There are a variety of other reasons for this, and I will offer my perspective on them.

So today I would like to begin by addressing the NADBank's successes thus far. I will also address what I see as the shortcomings of the institution's mandate. I will offer you my analysis as to why

certain things about the NADBank have worked and why others have not, and will offer you my opinion on what types of new initiatives and reforms could help the NADBank become as effective an institution as possible.

First, the successes of the NADBank must be recognized. Today, there are an unprecedented number of projects underway along the U.S.-Mexico border. In the seven years since the creation of the NADBank and its sister institution, the Border Environment Cooperation Commission (BECC), 43 infrastructure projects have been approved for financing, representing a total of US\$1.14 billion in infrastructure development. In the world of infrastructure development, this amount of work in a seven-year period is significant. Bear in mind that we are talking about \$1 billion in projects in a narrow swath of land 200 km wide that includes some of the fastest growing and poorest communities in the United States and Mexico. You also need to put this in historical perspective – more projects have been delivered to both sides of this border region in the last 7 years than ever before. The NADBank to date has approved financing of US\$379.1 million to support the development of these projects. In terms of infrastructure investment in the border region, a region that had been by and large neglected prior to the creation of the NADBank and the BECC, this is tremendous. As a result of this unprecedented level of investment in border infrastructure, some 6.1 million border residents are in the process of receiving adequate water, wastewater, and solid waste services where they did not have such services before. Thus, while I encourage this committee to

make all the changes necessary to improve the NADBank and the BECC, please do not ignore or worse, inadvertently eliminate, the parts that do work.

The NADBank and the BECC have developed projects that are financially and environmentally sustainable. Both institutions have focused on the fundamentals of public governance, from local democratic openness to fiscal responsibility. The work of these institutions has been with a long-term vision to ensure that the ongoing operations and maintenance of these projects will remain adequate and affordable for the communities they serve. The Bank can point to its record with its Institutional Cooperation Development Program (IDP) and its Utility Management Institute (UMI). Just last week I attended a meeting in Mississippi where the Department of Health's water quality enforcement officer stated that a new law requires all rural water system board members to be trained on the fundamentals of system management and governance. In her opinion, it is a requirement that has truly improved the long-term viability of Mississippi's water systems and its public's health. These programs work. They aim to develop and enhance the institutional capacity of the utilities that must sustain the long-term operations and maintenance of the projects the Bank finances. In my opinion, this work is among the Bank's most important. The creditworthiness of the communities in which the Bank provides financing can only be enhanced long-term if there is a continued commitment to institutional development programs at the Bank.

As I mentioned, the NADBank is participating in the financing of these projects to the tune of US\$379.1 million. Ninety-three percent, US\$354.6 million, of this has been in the form of grant funds from the Bank's EPA-funded Border Environment Infrastructure Fund – a fund that I helped create in response to the Bank's inability to lend. The NADBank has only directly loaned US\$23.53 million to date. This low level of direct lending has been the source of much of the criticism leveled against the NADBank, but this figure in and of itself is not an accurate performance measure. This grant-to-loan ratio is, however, indicative of the shortcomings of the Bank's original lending structure and mandate.

What we came to recognize at the NADBank as we began our work in 1995 is that the “bankability”, in the traditional sense, of the projects we were charged with financing was very limited. Those communities that are on the U.S. side of the border have various financing options that are permanently more appealing than the market rate lending program the NADBank can offer. These include tax-exempt municipal bonds, and state revolving loan funds, both of which offered interest rates with which the NADBank lending program could not nor should not compete. At the same time, the vast majority of communities on both sides of the border with environmental infrastructure needs are non-investment grade communities that will never be able to afford to finance projects with any market interest rate loans.

Despite limitations on the lending side, the NADBank's primary grant making facility, the Border Environment Infrastructure Fund (BEIF) has had great demands upon it, and the creation of this fund by the Bank has facilitated significantly greater equity in distribution of the EPA's border funds. Prior to the establishment of the BEIF, EPA border infrastructure funding was focused primarily on a few large international wastewater treatment plants with limited public involvement. Today, to EPA's credit, BEIF funds assist project affordability of all sizes and locations throughout the border region, done in a manner that requires local public participation and governance. While the Bank's primary lending programs have failed to work, the creation of the Bank and the BECC truly improved EPA's ability to create, fund and manage border projects - an unintended, but very good consequence.

The adaptation that was made by the Bank was to function in many respects more as a development agency, relying on its grant making facilities to be the catalyst it has been to this unprecedented level of infrastructure development. One thing that the Bank has not done, however, as pointed out by San Antonio business writer David Hendricks, is to straddle communities with debt that they cannot afford to service. The financing packages the Bank has offered have been based on detailed affordability analyses, and have been agreed to under rate and operating covenants that grant recipient communities must keep in order to receive funding, aimed at ensuring the long-term financial viability of the projects. At the same time, the Bank has recognized that grant funding, by itself, can do more harm

than good if it displaces local fiduciary responsibilities. A case-by-case balancing act must therefore be crafted for each community.

So, while we recognize the unprecedented level of infrastructure development initiated by the NADBank and the BECC, two realities exist: the first is that with only \$US23.5 million in direct loans, the vast majority of the Bank's paid-in and callable capital remains unutilized; the second is that the environmental infrastructure needs of the U.S.-Mexico border region remain immense, estimated at about US\$2 billion between now and 2005.

It is against this backdrop that the debate over reform and enhancement of the NADBank and the BECC has been initiated, culminating in the Monterrey Commitments agreed to by Presidents Fox and Bush on March 22 of this year. I will comment on these.

With regard to geographic expansion on the Mexican side of the border to 300 km from the existing 100km range, I believe it is a positive step toward broadening the reach of the Bank. I do not know the full details of the proposal, but I generally support it since many border problems actually originate in areas outside the 200 km zone. It is my understanding that preliminary demographic analyses by Bank staff indicate that this geographic expansion could make NADBank services available to approximately 5.6 million persons living in such communities as Monterrey, Hermosillo, and Saltillo. However, without additional changes to the Bank's charter I do not

see this change alone making a sufficient difference in the Bank's lending capabilities.

A second reform proposal offered out of the Monterrey meetings has to do with replacing the two distinct governing boards of the BECC and the NADBank with a single board of directors with representation from the two federal governments, the Border States and the public. This is a viable proposal that could help enhance coordination between the two agencies. However, viewing such changes to the current structure of the NADBank and the BECC as having the potential for dramatically impacting the performance of the institutions, such as the Bank's ability to lend more, is incorrect. A single board would improve the institutions focus and coordination on issues that do not present local community conflicts with each institution's distinctive mission. The BECC must continue to provide a mechanism for open public discussion and development of environmental projects. The Bank must continue to provide the local fiscal and operational framework needed for a community project's long-term viability. The first process results in a demand for more federal and state funding and the latter process results in a demand for more local funding. This conflict is unavoidable and results in very real political pressure on elected officials at all levels, system operators and the BECC and the NADBank. A single board must ensure that it has the internal mechanisms to meet each institutions mission and yet appropriately separate the decisions that are inherently in conflict. A single board can meet this task if the issue of unavoidable conflicts is properly examined and planned for.

The structure and process of the NADBank and the BECC should be improved and a single board will greatly assist in this goal. However, the constraints under which the NADBank has operated have much more to do with the mandate of the institution, rather than simply its structure or process. If the ultimate expectation is for the NADBank to perform as a lending institution and use its capital to its full extent, the solutions lie in expanding its sectoral mandate within reasonable boundaries. This would entail transforming the NADBank into an infrastructure development bank with a broader mandate, covering all infrastructure projects and corridors that are relevant for the economic development of the border region, while ensuring that environmental infrastructure concerns continue to be the primary focus of the Bank. The Bank's mandate should be expanded, in my opinion, to include any infrastructure project that benefits the border. Since both governments are adequately represented on and control Bank's Board decisions, I would delegate the future decision as to which projects are appropriate to its Board of Directors. What may seem to be inappropriate today may be of critical need tomorrow. The Bank must be flexible enough to appropriately act, with full public participation, without having to amend the bi-lateral agreement again. While it is my belief that BECC certification should continue to be required for the Bank's environmental projects, certification of a wide range of other infrastructure projects is not appropriate. Since public funds are being used, the a unified Bank/BECC Board should only ensure that all non-environmental projects have an appropriate public

process, but a project certification should not be required for the Bank's market rate loan funds to be accessed.

A second element of future growth and success of the Bank involves recognizing that environmental projects in most border communities will continue to require grants and technical assistance for years, before they are creditworthy. The Low Interest Rate Lending Facility (LIRLF) recently initiated by the Bank will help to make loans a practical option for many communities, but the Bank's *Five Year Outlook* shows that even that will not get the NADBank to fully use its current capital.

I believe it is worthwhile for this Committee and others that may assess the NADBank issue to study the experiences of all other multilateral development institutions in lending to environmental sectors. Not more than 7% of their portfolios are represented by such projects. This sector represents the entire universe of the NADBank, yet we expect it to be lending and fully utilizing its capital under such a narrow mandate. Ironically, the Bank's current lending represents 7% of its project funding activity, with the BEIF representing 93%.

At their inception the purpose of the NADBank and the BECC was to establish an institutional framework for helping both countries develop long-term solutions to the key infrastructure problems that stem from their expanding economic links. Preserving the capital of the NADBank and leveraging it in the markets is crucial to that effect. A more balanced and diverse portfolio is needed not for the Bank's sake, but for the rapidly growing population of the region.

These ideas are not new, nor do I claim exclusive ownership to them. Various analyses by individuals and groups who follow and work with the two institutions have reached similar conclusions. A proposal presented by the Mexican Government last summer expressed Mexico's need to fully use the Bank's capital and to respond to a broader range of infrastructure needs that are prevalent throughout the border region. A proposal presented jointly by the Texas Center for Policy Studies, the Willie Velasquez Institute and UCLA, and endorsed by the San Antonio Free Trade Alliance also provides a reasonable framework for expansion of the Bank's scope and use of its capital, while preserving its key role regarding the environment. I would encourage the members of this Committee to examine these proposals and others as part of its work in considering NADBank/BECC reform.

In conclusion, let me say that I believe the reform proposal offered out of Monterrey is clearly a step in the right direction. However, broader reforms are necessary if the NADBank is to live up to its potential and fully utilize its capital. I will summarize the key points I believe both governments must consider as the debate on reform moves forward:

- Despite many obstacles and limitations, the NADBank/BECC experiment has worked. Issues of structure and process are important but secondary to the issue of mandate reforms in terms of improving effectiveness. Institutional reforms must not be disruptive to the current workloads of the institutions, which are growing by leaps and bounds in terms of the number of

projects in the pipeline for development. Even as currently flawed, the NADBank and the BECC are providing needed services for communities that cannot afford to wait for a perfect solution.

- Grant funding, institutional development and technical assistance must remain key elements of the NADBank/BECC approach in order to foster the long-term operational sustainability and affordability of projects. Proper local governance and professional management of key public infrastructure is the only long-term solution – grant funding and technical training must leverage this outcome.
- Full utilization of the NADBank's capital will require further levels of mandate expansion into sectors outside the traditional environmental sectors, while maintaining environmental sectors as the primary mission of the institutions. Give the Bank's Board of Directors full discretion and flexibility on how this "open" infrastructure mandate is applied. A unified Board will ensure that the missions of both the Bank and the BECC are properly balanced as this mandate independence is exercised over time.

Again, thank you for this opportunity to address this committee as it considers this matter so important to the future of the U.S.-Mexico border region. I will be happy to answer any questions you may have.

David Hendricks: Confab players can learn from NADBank

San Antonio Express-News

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MONTERREY, Mexico — What's wrong with this picture?

The United Nations is holding its Conference on Financing for Development. The World Trade Organization is here. So are the World Bank, International Monetary Fund and Inter-American Development Bank.

Their goal? A plan to raise living standards in impoverished areas around the world.

The organization that ought to be here this week, but isn't in any visible way, is the San Antonio-based North American Development Bank, which finances water, sewage and landfill projects along the 2,000-mile U.S.-Mexico border.

NADBank's scope is minimal compared to most other development banks, which fund roads, education, utilities and health care initiatives on a scale ranging from regional to global.

Yet, NADBank can say something these other development banks cannot. It has not trapped a community or nation or region in debt it cannot repay.

Think about recent international monetary crises. Mexico in late 1994, East Asia in 1997, Russia in 1998, Ecuador, Ukraine, Pakistan, Turkey and finally Argentina in 2001 all were caught in the trap of debt to development banks at this Monterrey conference and to outside governments.

The debt loads end up crippling governments' capacities to sustain economic growth and to meet the social needs of their citizens.

What did NADBank do differently? It did its homework. It determined how much border residents could afford for utilities. Then it made a few, selective loans to places like Brawley, Calif., Ensenada, Mexico, and Ciudad Juárez, Mexico — cities with sufficient revenues to repay interest on top of regular utility rates.

NADBank took a lot of political heat for this. Millions of dollars were available to invest, but there was little to show for it.

NADBank managing directors like Victor Miramontes and Raul Rodriguez didn't blame anyone, though it was the bad U.S. Treasury bylaws that tied their hands. They made the

best of a bad situation, but they did not do what their global development bank brethren did, which is weigh down populations with debt they could not escape.

Only last fall was NADBank allowed to offer part of its capital at interest rates below commercial-bank rates. It is still too soon to know how effective that is in a region where even zero-interest loans often are not affordable.

Still, NADBank has helped the impoverished border zone in a way that never had been achieved.

Frankly, this "sophisticated" U.N. conference appears devoid of this kind of experience. A herd of bank and non-profit organization bureaucrats are blathering about a lot of things that were dozens of moves ago for NADBank.

NADBank should have the chance to expand its mandate to enter new sectors like roads, health care, housing and education.

Yet, the Treasury Department seems insistent on treating NADBank like some sort of tar baby that should be done away with, a process starting with some kind of merger with its technical-advising sister institution, the Border Environmental Cooperation Commission based in Ciudad Juarez, Mexico.

I asked U.S. Treasury Secretary Paul O'Neill on Wednesday during a Monterrey press conference about NADBank's future, mentioning San Antonio's fear that the bank may dissolve or leave San Antonio.

"Presidents Bush and Fox will spend quite a bit of time together over the next two days, and we have been working with our counterparts in Mexico under instructions from the two presidents," O'Neill said.

"Their interest is in creating institutions that produce substantive results," he added. "I do not want to pre-empt the presidents, but staff-level work has been productive, and there will be steps to create an institution that makes real contributions."

What does that mean? Given the implicit criticism in his answer that NADBank has lacked results, O'Neill seemed to say changes are forthcoming. What they are is anyone's guess.

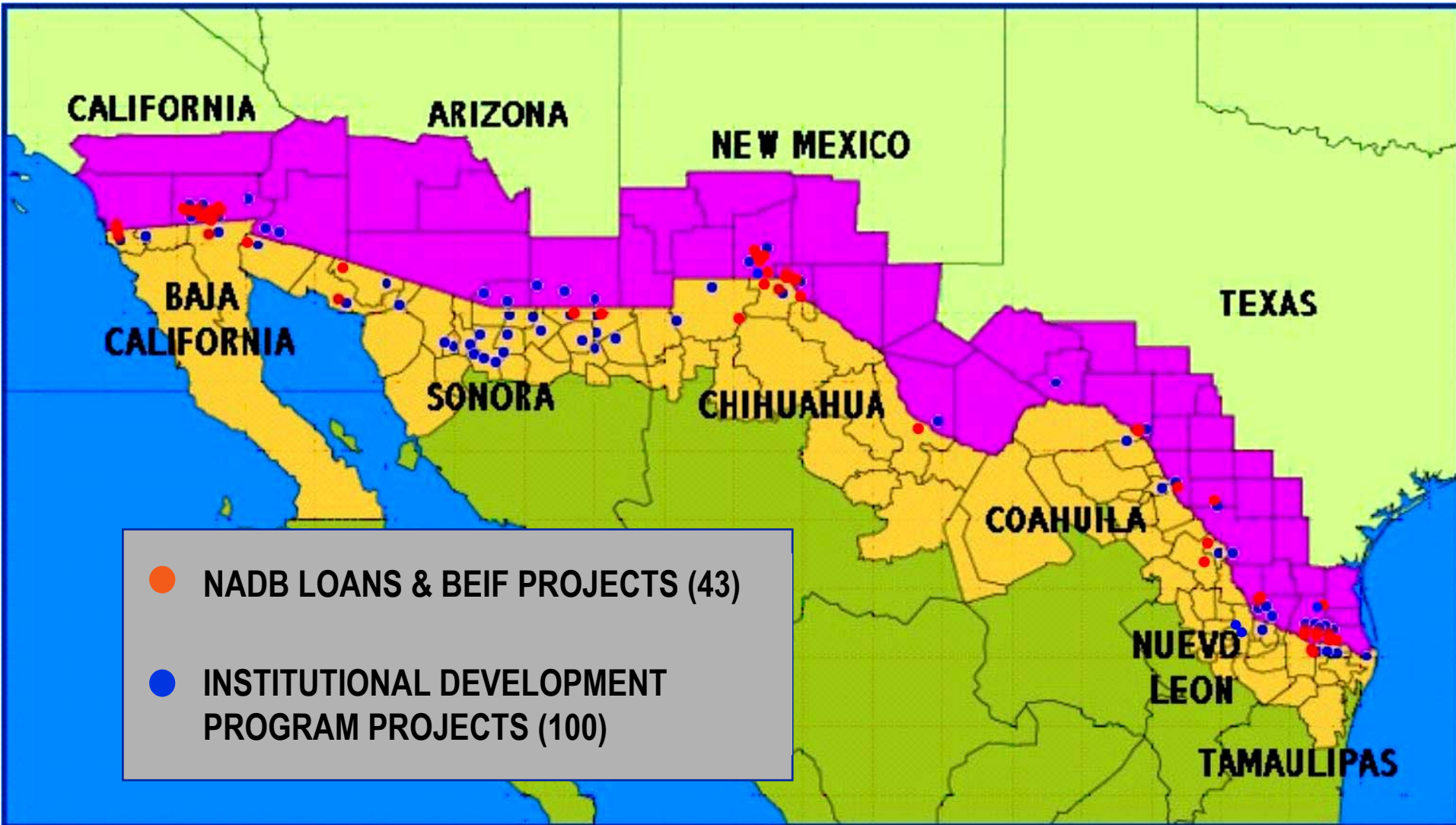
But NADBank, operating quietly in San Antonio, knows things this U.N. conference is struggling to learn: how to help people without the heavy yoke of debt.

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03/21/2002

NADB PROJECTS

MARCH 2002



NORTH AMERICAN DEVELOPMENT BANK

SUMMARY OF APPROVED FUNDING BY PROJECT

March 31, 2002

	Project	Type	Project Cost (US Dollars)	BEIF Amount (US Dollars)	Loan Amount (US Dollars)	SWEP Amount (US Dollars)
1	Agua Prieta, Sonora	SW	1,905,490	--	448,964	--
2	Alton, Texas	WW	14,476,621	259,396	--	--
3	Brawley, California (1)	W	24,900,000	--	972,329	--
4	Brawley, California (2)	W / WW	13,761,638	6,390,736	--	--
5	Calexico, California	W	11,330,000	6,477,320	--	--
6	Ciudad Acuña, Coahuila	WW	78,810,000	16,730,000	TBD	--
7	Ciudad Juarez, Chihuahua (1)	WW	31,490,000	12,188,000	4,640,474	--
8	Del Rio, Texas	W	44,630,000	15,180,704	--	--
9	Doña Ana County, New Mexico	WW	27,842,100	12,058,444	--	--
10	Donna, Texas	W / WW	21,617,000	2,607,365	--	--
11	Douglas, Arizona	W / WW	8,468,034	3,714,685	TBD	--
12	Eagle Pass, Texas	W / WW	105,344,092	17,994,097	--	--
13	El Paso, Texas (JRWTP)	W	37,822,343	14,906,458	--	--
14	El Paso, Texas (LVWD)	W / WW	100,350,600	17,500,000	--	--
15	El Sasabe, Sonora	WW	935,062	467,531	--	--
16	Fabens, Texas	W / WW	9,739,133	6,100,177	TBD	--
17	Heber, California (1)	WW	3,383,800	1,082,725	--	--
18	Heber, California (2)	W / WW	4,542,400	2,528,375	--	--
19	La Union, New Mexico	WW	7,273,050	4,769,444	--	--
20	Laredo, Texas	W / WW	21,581,262	6,231,450	--	--
21	Mercedes, Texas	W / WW	10,983,154	896,075	1,874,900	--
22	Mexicali, Baja California	WW	57,360,000	20,620,000	--	--
23	Naco, Sonora	W / WW	2,070,308	945,154	180,000	--
24	Nogales, Arizona	WW	74,395,974	59,504,955	--	--
25	Ojinaga, Chihuahua	SW	1,773,760	--	--	500,000
26	Piedras Negras, Coahuila	WW	56,820,000	8,400,000	TBD	--
27	Puerto Palomas, Chihuahua	WW	5,184,280	1,880,300	TBD	--
28	Puerto Peñasco, Sonora	SW	2,177,284	--	496,243	--
29	Raymondville, Texas	W	7,445,343	4,509,706	--	--
30	Region Cinco Manantiales, Coahuila	SW / WW	20,981,800	--	8,590,000	--
31	Reynosa, Tamaulipas	WW	83,400,000	33,500,000	TBD	--
32	Roma, Texas	W / WW	34,177,640	5,572,450	--	--
33	Salem/Ogaz, New Mexico	WW	2,818,501	991,912	--	--
34	Sanderson, Texas	WW	3,638,099	352,042	--	--
35	San Diego, California	WW	99,588,000	17,202,462	--	--
36	San Luis Rio Colorado, Sonora (1)	WW	13,700,547	5,935,545	TBD	--
37	Somerton, Arizona	W	3,436,791	1,069,823	--	--
38	Tecate, Baja California	W / WW	8,237,671	3,718,780	TBD	--
39	Texas Plan (Hook-ups)	W / WW	8,820,000	6,356,700	--	--
40	Tijuana, Baja California (1)	WW	27,430,000	16,000,000	6,320,000	--
41	Tijuana, Baja California (2)	WW	42,014,408	18,007,204	TBD	--
42	Uvalde, Texas	SW	3,415,000	--	--	500,000
43	Westmorland, California	WW	4,607,220	1,977,500	--	--
TOTAL APPROVED TO DATE:			1,144,678,405	354,627,515	23,522,910	1,000,000

W = Water

WW = Wastewater

SW = Solid Waste